AN ASSESSMENT ROLL FOR THE INCOME TAX

In well-ordered taxation there are always three distinct steps: levy, assessment, and collection. Levy, under American law, is a legislative act precedent to, and necessary to the legality of, the other steps. A tax can be levied only by a legislative body and the levy requires a statute or its equivalent.[1] Assessment is the administrative determination of the amount each person is to pay according to the provisions of the levy. Collection (a self-explanatory term) follows, and follows only, after a levy and an assessment. These elementary definitions are repeated by way of preface.

In a direct tax the process of assessment is usually very deliberate and formal. When completed the assessment of a direct tax is generally recorded in a formal document, known by various names but sufficiently described as the assessment roll or tax list. The assessment of a direct tax is in effect an apportionment among the several taxpayers of the amount levied. Sometimes that amount is a determinate sum as $5,000,000. In other cases it is an indeterminate sum, the result of a rate applied to the property, the income, or some other base. But in either case, the roll brings together and lists all the taxpayers and shows their respective shares of the tax.

The assessment roll is an important legal document. It is important not only as a record of official action past, but as the legal warrant for future action, collection, and again, thereafter, as the basis of audit. It is good sound law and good safe practice to prescribe that no officer may legally collect a direct tax without the warrant of an antecedently prepared assessment roll. It is long accepted American theory and practice that the assessor and the

[1] Occasionally, by a careless use of language, an executive office is directed by law to "levy and assess" a tax. But since the legislature cannot delegate its power to levy a tax, such language in a statute is void of meaning so far as the word *levy* is concerned.

collector have distinctly separate functions which may not be intrusted to the same office.

In most of the American commonwealths the formal assessment roll is the sole warrant for the collection of the property taxes. When, as has occasionally happened, some less formal warrant for collection, such as a mere tax bill, is authorized in place of the roll, grief has come sooner or later to the taxpayers and to the government.

The formal roll, as a record of deliberative proceedings officially initiated, has sometimes been regarded as affording one of the earmarks of a direct tax in distinction from an indirect tax. The difference in this respect between a direct tax and an indirect tax is not that assessment, in some form, as an essential step is missing in the indirect tax. Assessment never can be omitted in any tax. But in the case of an indirect tax it is less formal and may be a mere incident to collection. For indirect taxes the collector may be also the assessor. There is no formal roll for the indirect taxes, because the duty to pay such a tax occurs at irregular intervals of time and falls only on those persons coming by their own acts, not by the act and search of any officer, under liability. It is one thing to sit at receipt of customs and take toll of importers. It is quite a different thing to go out and round up, list, and assess all persons subject to a property tax and to value their properties. Customs appraisers, of course, make assessments by valuation too, but they do not write an assessment roll. It lies in the very nature of an indirect tax that no roll can be assembled in advance of liability to pay, while it lies in the nature of a direct tax that liability to pay can be made contingent upon an assessment roll.

The thesis we propose to defend here is that the preparation of a proper income-tax assessment roll, in advance of collection, would vastly improve the administration of the federal income tax. The roll should be conclusive and final for each year as to who is liable to income tax and for how much he is liable. We believe that the failure to make an income tax roll is fraught with danger, involves present practical evils, and that it runs counter to our best traditions of taxation. These traditions were established when democracy was in the making, when the control of the purse

by the people through their representatives was first won, and when taxes were made certain and not arbitrary. The roll is one of the means which protect the rights so won. The lawyers have a saying that tax proceedings are always in *invitum*. In so far as this is true, taxation procedure must, like every other invasion of the rights of property and of liberty, follow rules which insure the rights of the taxed. It must also have its proper formal records.

But have we not an assessment of the income tax now? Yes, we have an assessment, but no final and conclusive roll. Moreover, the assessment is far from formal and is more after the model of an assessment to an indirect tax than an assessment to an important direct tax. It is not antecedent to payment, but coincident with or subsequent to payment. The so-called official assessment is more nearly an audit or approval of the taxpayers' own self-assessment than an original officially initiated act.

Let us run over the steps in procedure as laid down in the Revenue Law of 1918, following for sake of simplicity the procedure relating to an individual, a resident citizen. First, each individual decides for himself whether he is taxable or not, and if he decides that he is taxable he makes a return (sec. 223). He files the return with the collector (sec. 227*b*), and pays the whole or one-fourth of the amount that he himself has determined to be due (sec. 250). This is an assessment—of a sort; we may call it self-assessment. It is often the only one there is that is deliberatively made. The collector examines the return and may "increase the amount of the return" (sec. 228), but may not lower it. Possibly if the collector thinks that the return is too high he will allow the taxpayer to withdraw it and file a new one. This looks a little like an official assessment. But so far as the strict letter of the law goes it is one-sided. It is not technically under the law an assessment at all. Nor is it final. It is more like an audit, although in no way a conclusive audit. It should be added that the department has provided advisors to instruct and guide the taxpayer in making his return.[1]

[1] The common criticism that the advisors were not well informed, and that it was a case of "the blind leading the blind" is distinctly unfair to the intent and purpose of the advisor plan. What was done was distinctly the best that could be done under the circumstances and under the provisions of the law.

The commissioner now enters, and "as soon as practicable after the return is filed" examines it. He may raise or lower the amount of taxable income or he may leave it unchanged (sec. 250*b*). This is technically the *assessment*. This step in the procedure is explained by Montgomery as follows: "The Commissioner of Internal Revenue assesses the tax at Washington, but forwards the tax bills to local collectors for delivery to tax-payers."[1] The law does not provide in so many words for tax bills, but for "notice and demand." But Montgomery is right as to the practical effect. It appears then that the warrant for collection is theoretically the order of the commissioner directed to the collector to give notice and make demand. At the best this is a most informal warrant. Before the passage of the Revenue Law of 1918 the tax was not due and payable until after notice and demand by the collector, and a short interval existed for assessment before payment. But under the present law, at least one-fourth of the tax is due at the time the return is filed. That is, payment is required before assessment. This is certainly not orderly procedure.

To carry out his functions the commissioner is armed with experts and inspectors and has the power to round up individuals who have not made a return, as well as those who have, and to examine individuals and their books of account. It will be observed that this is strikingly like the procedure in the case of an indirect tax. The importer comes in with his declaration, the collector examines it, if appraisal is necessary the appraisers act, the tax is due immediately, and the whole is subject to review; meanwhile revenue agents are hunting for smugglers.

But the action of the commissioner is not final and whatever memoranda of assessments he may keep never reach the dignity of an assessment roll. He has full power to reopen any assessment, or to make one where none was made, at any time within five years (sec. 250*d*). That is, a taxpayer whose return, honestly made in good faith, was accepted without criticism by the collector, and whose "notice and demand," or tax bill, followed the figures in the return without change and who has paid accordingly, may at any time within five years be reassessed and have to pay more,

[1] *Income Tax Procedure*, 1919, p. 130.

or, as the case may be, become entitled to a refund. There is no finality to the assessment until by the lapse of time, five years, a sort of statute of limitations comes into operation. In the case of false fraudulent return there is no time limit, which is perfectly proper. Under such conditions there can be no conclusive roll.

The returns are declared a public record (sec. 257). But the assessments are not so declared. This is striking evidence of the confusion of thought, for it is the assessment, not the return, that ultimately establishes the obligation to pay. Nowhere is there a legally constituted formal tax list or assessment roll, public or other. We venture to repeat that no matter how carefully the commissioner's books may be kept or the collector's lists made up, they do not have the force of a roll.

Let us now compare these scanty provisions for assessment to income tax with the orderly procedure which the experience of many years has created for the assessment to property tax. We follow the type of procedure which is found in many of our commonwealths. The variants therefrom alter in no essential the substance of what follows.

First, there is a return, or declaration by the taxpayer. This is not conclusive either as to quantity or as to value, for it is the duty of the assessor and of no one else to assess. Second, there is an assessment by an office of assessment expressly constituted for that and for no other purpose. The assessor does not act in the capacity of collector, nor is the collector an assessor. Even in very small communities, where for sake of economy the two offices are in the same person, he acts admittedly and distinctly in two different capacities, and at different times in each. The separation of these functions is regarded as essential. Third, comes the preparation by the office of assessment of a formal roll. This roll is hedged about with all manner of safeguards and is a public document of the very first importance as regards the validity of the taxes and also as regards the property rights affected. Informality invalidates. In some cases an informality so slight as the omission of the dollar mark before the figures has been held to invalidate the assessment. The roll is legal evidence of tax liens. Fourth, there

is a review by local boards and sometimes by other authority as well. The review may be initiated either by the government or by the taxpayer. Fifth, comes the extension on the roll by the properly constituted auditing authority of the taxes due; that is, the multiplication of the assessment by the rate. At the end of this stage the assessment proper is finished. The final and conclusive roll has been written. Doom has been pronounced and sealed. No one can again be placed in jeopardy for that year's taxes. Sixth, the roll so constructed passes to the collector and becomes his warrant for collection. On it he enters for permanent record the taxes paid and those which went delinquent. Seventh, when the collection for a given year is completed, the roll serves its final purpose as the basis of audit and record. It enables the collector to secure his clearance for taxes collected and for taxes delinquent. It serves as the record of tax liens removed and of liens still running.

Steps one to five result in the formal roll, which, save for the necessary reservations as to clerical errors and detected frauds, is final and conclusive as to the taxes assessed for the year. There is normally no such thing as reopening the roll or any entry therein, nor of adding thereto. In passing it may be noted that sufficient time is usually allowed for each of the first five steps to safeguard the interest both of the government and of the taxpayer.

The question may now be asked whether, in the case of the federal income tax, the disregard of logic, the breach of long-respected legal theory, and the non-observance of the teaching of experience have resulted in any serious practical evils? Is it merely a matter of form and of red tape that we are discussing or is it the kind of unseemly haste which proverbially makes waste? We believe that evils have resulted and that there is afforded by the lack of system, uncertainty, and informality a fertile ground in which other evils may spring up. It may be that the evils have not culminated yet in a way to be acutely felt. But now that the war is over and people will be inclined to be more critical of and to resist arbitrary taxes, these evils will be more acute.

We are not attempting here to exhaust the subject, so we may be content with mention of the three chief evils traceable mainly

to the absence of an assessment roll, but partly to the loose methods of assessment which make it hard to write a roll.

1. For the enormous sums collected since 1913 in income taxes (and in excess and war profits taxes) from individuals and corporations, no taxpayer, individual or corporate, save only the very few whose cases have been adjudicated in court, has yet received a final clearance of the tax liability for any one year. Every return, every failure to make a return, whether proper or not, is still open to review. All that the taxpayer has to go on is, at first, the silence and apparent acquiescence of the commissioner, then an inconclusive revisable "notice and demand," and finally (if he has chanced to demand one) a receipted bill for the amount he has paid, but which gives no assurance that it was the right amount. Liens have run against his property and have, presumably, been removed. But the only evidence there is of removal is the receipted tax bill and that is inconclusive evidence. By regulation one's own canceled check is just as good as a receipted tax bill. There is no public record of the removal of the liens. No taxpayer can know when the whim of some officer, the hobby of an expert, the vagaries of an inspector, or a change in the rulings of the commissioner may cause his return or failure to make a return for any year past to be "re-examined" and the tax recomputed. On any day he may receive a curt note reading in substance: "Your income tax for the year———has been recomputed. Pay the collector within ten days $———." We should not be misunderstood to imply that a lien for taxes attaches until there has been an assessment or reassessment. Property transferred is not followed by a lien for income tax unless it is transferred in the interval after "notice and demand" but before payment. The evil is not a blot on titles so much as the inconvenience perpetually impending of a sudden and unexpected demand. It is this uncertainty that is so disconcerting. Nobody knows when or where the lightning may strike, and the thunderstorm lasts five years.

2. The method of inspection, a thing made necessary by the loose procedure and by the absence of a roll, is essentially a post-payment or post-due assessment. It is like a post-audit where pre-audit is indicated. It is, moreover, since it follows a presumptively

fair self-assessment, a spy system, and is undignified and autocratic, especially when applied to a direct tax. The method is essentially the same as is used to run down smugglers and "moonshiners." It is applied alike to the just and the unjust. It has all the evils of the iniquitous "tax inquisitor system" except those which arose from the fact that the inquisitors were paid by commissions. It has the essential wickedness of penalizing the innocent citizen for administrative and legislative neglect. There is a deal of difference between sending out deputy assessors to list the taxpayers before assessment and sending out detectives to catch delinquents after assessment. With the assessor the taxpayer can co-operate; before the inspector he stands on the defensive. It is a method well calculated to cause friction and to engender obstinacy and resistance.

3. Despite the seemingly extraordinary and unusual powers bestowed on the taxing branch of the government, the absence of an assessment roll leaves the government weak at very essential points. Not only do its officers collect money on a very imperfect warrant, largely by the grace and consent of the taxpayers, but these same officers can never get a full and complete clearance of duty done or of taxes honestly collected and duly accounted for. It is quite true that dishonest men cannot be made honest by any machinery of bookkeeping or by tricks and devices of audit. But it is also true that honest men can be tempted to dishonesty, and dishonest men given facility for stealing by loose methods. There is no known method of audit for taxes due and collected as good as that system which centers around the assessment roll in the manner outlined above as used in the property tax. The absence of an assessment roll antecedent to the collection of the income tax makes the misappropriation of public money collected, the collection of "fake" taxes, and the compounding of evasion so easy and so safe as to constitute a severe test of the fiber of honesty in our officials and in our taxpayers. But worse even than the opportunity and incentive to actual crime which the method involves, the present system puts the honest collector and the conscientious inspector where he can never disprove a false charge of malfeasance. Furthermore, since the taxpayer has no roll or

other public proof of assessment to refer to, the suspicion that he has not been properly assessed is ever present.

How we fell into this mess is not at all easy to understand. One would have thought that the general principles involved were too familiar to be forgotten. Yet it seems to have been believed that the federal government is superior to those practical mandates to which the sovereign commonwealths see fit to bow. Historically, there were proper assessment provisions in the Civil War income-tax law. Those broke down, as is well known, because of the imperfections of the civil-service system at the time. While much of the Civil War tax law was copied into the law of 1894, the assessment provisions were not so copied. The law of 1913 followed in turn the omissions of the law of 1894. But that tax was small and the number of taxpayers was not large. There existed at the time the strong and well-organized office of internal revenue, to which it was natural to turn over the new tax. Perhaps it was natural too that this office should follow for this new but direct tax the methods of collecting indirect taxes to which it was accustomed. Then came the war with its need for new revenues—now, right away, in a hurry. Deliberate assessment takes time, and the situation demanded that there be no loss of time.

But possibly more decisive than any other factor affecting our question has been the prevailing desire for secrecy of the returns and of the individual's tax. One's income seems such an intimate matter. This doubtless influenced the method of assessment. Lastly, there was and there still is a widespread but erroneous belief, born of ignorance and inexperience with income taxation, that income is an easy thing to determine.

It should after these years of experience be obvious to all that income is not at all easy to determine and assess. If anything, it is harder to determine the incomes of a million people than it is to determine their properties. Not even the defining of income is easy. Economists have written many volumes about it, and by way of illustration of the difficulties encountered one may cite the fact that Professor Irving Fisher in his big book comes to the conclusion that income as he sees it and defines it would not afford a practical basis for an income tax. The income-tax law itself goes

into many minutiae as to what is taxable income and what is not. The official rulings in interpretation of the law now fill more than a five-foot bookshelf. The courts have decided some points, but not many. One of the most important is now before them, namely, whether increment in property value is income. In face of all this, it is naïvely assumed that every taxpayer can assess his own income with such accuracy that no more formal procedure of assessment is necessary than can be found in so casual an inspection of the return as is now contemplated by the law. There is truly as much room and need for the exercise of sound judgment and wise discretion in the assessment of income for taxation as there is in the assessment of property. All of this points with equal force to the necessity for an assessment roll, without which the best efforts are apt to be inconclusive, if not vain.

There may be reasons which can be advanced in favor of self-assessment to income tax other than the desire for secrecy. But it seems safe to assert that the reason for self-assessment which has the widest appeal is the desire to keep one's affairs from the prying eyes of one's neighbors and of gossips. Possibly the fear from which this desire for secrecy springs may wear away with longer familiarity with the new tax. Some secrecy will have to be sacrificed in any more efficient method of assessment. How much would be sacrificed would depend on the machinery adopted and the number of officials involved. There does not, however, appear to be any large degree of annoying publicity involved in the current method of assessment to property tax.

But the main point here is with the assessment roll. This would necessarily be what the returns are now declared to be, a public record. But it could not be held so screened from the public eye as are the returns now. Some degree of secrecy would be sacrificed. The roll must, to serve its purposes, contain the name of each taxpayer, his taxable income in at least such detail as would show the application of the rates, and finally the amount of tax due. More it need not contain. Since it is a record of taxes assessed and ultimately of taxes paid, it is a record of facts and conclusions only. It need not contain the information on which the conclusions were based and the returns could remain, as

now, confidential between the assessor and the taxpayer. It is not necessary (we do not now raise the question of desirability) that the roll be given any more publicity than such as now actually results in most states from the property tax roll. Those rolls are inspected by taxpayers in connection with review and, when looking up their taxes, by searchers of records and by others properly interested in the liens which the taxes create. It is rare indeed that they are examined by anyone from idle curiosity or for purposes unfriendly to the taxpayer. The amount of usable information which a business rival can glean from them is insignificant. Exactly so would it be with the income tax roll. Whether the publicity involved is likely to prove so annoying as to warrant the continuance of the evils above alluded to is something upon which opinions may differ. It is our opinion that the loss in secrecy would be so trivial as to be negligible.

Unless we wander off into vague philosophical considerations, such as the importance of making civic duties felt, the only reason for self-assessment other than secrecy is the advantage of using the taxpayer's intimate knowledge of his own income. But this applies to the declaration or the return with far more force than to the assessment. It has little bearing on the main question, which is as to the need of an assessment roll, however the assessment may have been made.

Alarm may be felt that the proposed change would cause added expense. We are of the opinion that it would result in a saving. It is always more economical in the long run to be tidy, accurate, and systematic than to be loose and slipshod. Besides, the taxes now lost and the money sure to be embezzled and otherwise misappropriated without a roll will easily pay for the writing of a roll many times over. But even if it did cost the government something, the gain in certainty to the taxpayer is worth infinitely more.

The thesis for which we have been contending is so simple that an appeal to authority seems almost superfluous. Textbook writers legal and financial alike have few words on the subject, for they all take for granted the principle involved, namely, the necessity for certainty. What we have said above is no more than the application to a special case of the famous dictum of Adam

Smith which might have been written with the very same facts before him:

> The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, *ought all to be clear and plain to the contributor, and to every other person.* Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favors the corruption of an order of men who are naturally unpopular, even when they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that *a very considerable degree of inequality,* it appears, I believe, from the evidence of all nations, *is not near so great an evil as a very small degree of uncertainty.*[1]

It may be contended that the foregoing discussion, being confined to the roll, does not go far enough, that more accurate, or, to use an overworked term, more "scientific" assessment is necessary as well, and that boards of review more accessible to the taxpayers than the commissioner, "way off in Washington," are desirable. The contention is cordially accepted. But although it would be not too difficult to outline on paper a model system of assessment to income tax, it may be observed that it is the lesson of history that practical methods of assessment are more likely to grow out of a series of felt necessities than to be successfully invented in the closet of a theoretician. The assessment roll is an obvious immediate necessity; it is the easiest, first step to take.

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NOTE

Friends who kindly read this article in the manuscript have made several suggestions of importance which should be added. Professors Seligman and Haig thought that there are other weaknesses in the administration which might receive attention as well as the one alone covered in the article. They also suggested that there would be a problem arising from our practice of allowing reports on the basis of fiscal

[1] Italics are ours.

years. It is obvious that if the returns do not all come in at the same time the writing of a final and conclusive roll is difficult. It appears to me, though, that this is a matter of technical detail. There is no impossibility in having a roll a part of which closes at one date and another part at another date. It would be better than none at all, or one that never closes. There is a question, however, whether the alleged convenience to the tax-payer of reporting for his own fiscal year is worth the confusion to which it even now gives rise.

The same gentlemen have suggested that a review of the practices of other countries would throw light on the points raised. It no doubt would do so, but I am inclined to think that we must be guided by American practice and principles and that we have ample home experience in this technical matter. The Canadian income-tax law does provide for a roll and for a short period for making the assessment. It also gives the tax-payer a proper hearing and review. The time allowed is none too long and the law is none too clear. But the principle for which my article contends is recognized. Great Britain's tax is largely an assessed tax and it is, moreover, a tax on "property and income" so different in form and administration from ours that there is no parallel. In one respect, however, we could copy after them to advantage. That is in providing the tax-payer with a proper local board before which he can present his grievances and which has the power to afford him immediate relief and reimbursement if he be entitled to it. As the matter now stands in the United States it costs a great deal of money, time, and trouble to get a hearing and an adjustment of an unfair tax.

Professor Millis thinks that too little emphasis was placed on the difficulty of assessing income and the necessity for time in which to do the work properly. Although the matter is mentioned in the foregoing article, he is no doubt right as to its great importance. For making the assessment for the property tax we allow a period varying from three months to seven months. The work of assessing an income tax is more difficult than that of assessing a property tax.

Professor Millis also suggests, and I agree with him, that collection at the source may have had something to do with getting us into this mess. In another article, to appear in the December, 1919, issue of the *American Economic Review*, I have discussed some of the discriminations which arise from the taxation of dividend income at the source.

Although, indeed grateful for these suggestions, I have left the article as it was originally written because I desired to hew as close to one line as possible. The one line is: *Let us have an assessment roll.*

All other matters are illustrative or relate only to the possible form of the roll or methods of assessment. I am satisfied that with three hundred years of experience, and the present practices of fifty-two states and territories to draw upon, we know how to frame the details of a good assessment system. We all know perfectly well what are the methods that are sound and just what perils to avoid. All that is lacking is the will to have an assessment system.

C. C. P.